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NO. 90-1601

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1990

LILLIAN H. HALL, ET AL.,

Petitioners,

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, ET AL.,

Defendants.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit

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PETITIONERS' REPLY TO BRIEF IN OPPOSITION

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ARGUMENT

I. THE FEDERAL RESPONDENT IS INCORRECT IN ASSUMING THAT PETITIONERS DO NOT CHALLENGE THE COURT OF APPEALS' HOLDING THAT FSLIC ACQUIRED AN ASSET

A. The Court of Appeals' Holding that FSLIC Acquired an Asset is a Subsidiary Question Fairly Included in the Question Presented

The question presented in this case by the petitioners is "[w]hether the *D'Oench* doctrine bars suit against the FDIC

even when no assets have been acquired by the FDIC from a failed banking institution". Pet. i. The respondent argues in its Brief in Opposition (hereinafter cited as "Brief Opp.") that because the court of appeals held FSLIC acquired an asset when it acquired Commerce, "[t]his case does not raise the question petitioners seek to present." Brief Opp. 6. That argument by the respondent is premised on the assertion that the court of appeals *was correct* in holding that the FSLIC acquired an asset. Contrary to the respondent's assumption, petitioners do challenge that holding.

Rule 14.1(a), S. Ct. R., states in pertinent part, as follows:

> The statement of any question presented will be deemed to comprise every subsidiary question fairly included therein. Only the questions set forth in the petition, or fairly included therein, will be considered by the Court.

The question posed by petitioners assumes "no assets have been acquired . . . ." Therefore, the holding to the contrary by the court below is a "subsidiary question fairly included" in petitioners' question presented.

It is required that special and important reasons be brought to this Court's attention before a petition for a writ of certiorari will be granted. Rule 10.1, S. Ct. R. The function of a petition for a writ of certiorari is to demonstrate that such special and important reasons are present in a given case, not to argue the merits of the lower court's holding on those issues. Petitioner humbly suggest that the petition filed in this case does state reasons sufficient to warrant review on the merits by this Court. It is only within the context of that review, however, that the lower court's holding that an asset *was* acquired becomes significant.

B. It was Improper for the Court of Appeals to Raise Issues Contrary to the Factual Predicate Relied on by All Parties in the District Court

At no stage of the proceedings below, either in the district court or the court of appeals, did either of the respondents ever contend that FSLIC acquired an asset. Nor did the district court or the court of appeals ever question whether there was a dispute as to whether an asset had been acquired. It must also be remembered that this case was decided by the district court on cross-motions for summary judgment. By ruling in favor of the respondents, the district court held that there were no material factual disputes between the parties. However, without the development of a factual record or briefs by the litigants on the question of whether the FSLIC acquired an asset from Commerce, in its opinion the majority below for the first time interjected an issue in this case not theretofore in dispute. This Court has previously ruled that it is improper for an appellate court to enter summary judgment "on a new issue as to which the opposite party had no opportunity to present a defense before the trial court." *Fountain* v. *Filson*, 336 U.S. 681, 683 (1949). Whether the FSLIC acquired an asset from Commerce when it failed was not a fact in issue when the district court granted the FSLIC's motion for summary judgment. The district court's ruling was premised on the uncontested fact that Commerce had *not* acquired an asset, but that the FSLIC was nevertheless entitled to judgment as a matter of law. It is that holding that was briefed and argued in the court of appeals. The eagerness of the majority in the court below to beg the question of whether the FSLIC did or did not acquire an asset suggests that the majority is less than comfortable with its decision on the real legal question present in this case: Does *D'Oench* apply when *no* asset has been acquired? Since all parties assumed for purposes of the cross-motions for summary judgment that *no* asset was acquired by the FSLIC, and since it was on that basis that the district court ruled on the motions, it cannot be said that petitioners had "a full and fair oppor-

tunity to ventilate the issues" raised *sua sponte* by the majority in the court below, that an asset was acquired by the FSLIC. *Heinz* v. *Commissioner of Internal Revenue*, 770 F.2d 874, 876 (9th Cir. 1985); *Cool Fuel, Inc.* v. *Connett*, 685 F.2d 309, 312 (9th Cir. 1982). Since it was improper for the court of appeals to raise the issue, it is respectfully submitted that it would also be improper to deny the petition for a writ of certiorari on that same ground.

C. No Asset was Acquired by the FSLIC

While petitioners do not intend to argue the merits of this case at this stage of the proceeding, since respondent has raised the issue, prudence requires that petitioners briefly address the majority's holding that an asset was acquired. The majority reasoned as follows:

> Commerce, like the plaintiffs, possessed a continuing interest in the entire loan agreement after the $200,000.00 was repaid. Clearly the obligations represented by the loan agreement were not extinguished upon repayment of the $200,000.00; otherwise, the plaintiffs would have no colorable breach of contract claim. When FSLIC succeeded Commerce in its rights and duties under the loan agreement, FSLIC assumed an interest in whatever obligations remained under the loan agreement.

Pet. App. 11a.

First, the majority is incorrect in saying that "Commerce, like the [petitioners] possessed a continuing interest in the entire loan agreement after the $200,000.00 was repaid." The fact that petitioners brought suit for breach of contract shows that they possessed a chose in action based on Commerce's breach of the loan agreement, not "a continuing interest in the entire loan agreement" itself. Second, when the majority states that "the obligations represented by the loan agreement were not extinguished upon repayment of the $200,000.00;

otherwise, the [petitioners] would have no colorable breach of contract claim", the court must have been referring to *obligations* on the part of Commerce. Petitioners certainly did not owe any further obligations to Commerce after paying off the loan in full and obtaining releases in 1985. R. 16, Collective Ex. A. The undisputed facts regarding whether there was an asset for the FSLIC to acquire when Commerce was closed can be summarized as follows: petitioners signed a loan agreement with Commerce in 1983 and drew $200,000.00 on a construction loan; petitioners paid off the loan in full, under protest, in 1985, and releases were obtained from Commerce; petitioners brought suit against Commerce in 1987 for breach of the loan agreement. Can this Court let stand a characterization of the "obligations" owed by Commerce to the petitioners as assets? According to generally accepted accounting principles, owing an obligation is characterized as a liability.

This Court's decision in *D'Oench, Duhme & Co.* v. *Federal Deposit Insurance Corporation*, 315 U.S. 447 (1942) was based on "a federal policy to protect . . . the securities or other *assets* in the portfolios of the banks which [the FDIC] insures. . . ." *Id.* at 457 (emphasis added). Since no assets were acquired in this case, the federal policy that gave birth to the *D'Oench* doctrine is not implicated and the decision of the court below should be reversed.

The analysis of the majority in the court below on the question of whether FSLIC acquired an asset is flawed in another very important respect. As pointed out in the petition, another panel of the Sixth Circuit held in *Commerce Federal Savings Bank* v. *Federal Deposit Insurance Corporation*, 872 F.2d 1240 (6th Cir. 1989), that when the FDIC does not acquire any assets from a failed bank § 1823(e) cannot be raised as a defense. To avoid application of the *Commerce Federal* decision to the instant case, the majority below held: "We do not believe that the common law doctrine of *D'Oench* is limited by the terms of § 1823(e). It is settled that *D'Oench* and § 1823(e) are not identical in scope." 920 F.2d at 339.

Apparently, the majority below felt that by concluding *D'Oench* was broader than § 1823(e), *Commerce Federal* was of no precedential value in considering the outcome of the instant case. What the majority below failed to recognize was that in *Commerce Federal*, as in this case, all obligations owed to the insured financial institutions were paid in full prior to the time they were closed. Ignoring that significant fact, the majority in the court below held that *Commerce Federal* was of no precedential value in this case because the issue presented herein concerns the application of the *D'Oench* doctrine, while the panel in *Commerce Federal* was concerned with Section 1823(e).[1] The *Commerce Federal* decision cannot be so easily brushed aside. In both *Commerce Federal* and the instant case obligations owed to insured financial institutions were paid in full prior to the time those institutions were closed. In *Commerce Federal* a Sixth Circuit panel decided no asset was acquired, but in the instant case another Sixth Circuit panel, under the same facts, decided an asset was acquired. In that regard, the majority below did not distinguish the *Commerce Federal* decision, and quite frankly, there is no way it can.

With all due respect to the majority below and the respondent, the contention that the FSLIC acquired an asset is a red herring. The FSLIC assumed a contingent liability. It did not acquire an asset. For that reason, and the reasons stated above, petitioners still believe the petition to be well taken and respectfully request that it be granted.

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[1] It is ironic that several of the cases cited by respondent in its Brief in Opposition conclude that the *D'Oench* doctrine and § 1823(e) are functional equivalents. One of the cases, *Twin Construction, Inc.* v. *Boca Raton, Inc.*, 925 F.2d 378 (11th Cir. 1991), cites the Fifth Circuit case relied on in the petition to demonstrate that a conflict exists between the Fifth and Sixth Circuits, *Olney Savings & Loan Ass'n* v. *Trinity Banc Savings Ass'n*, 885 F.2d 266 (5th Cir. 1989). The *Twin Construction* court held:

> [C]ourts have found the aims of section 1823(e) and *D'Oench* identical and thus have construed defenses premised upon section 1823(e) and *D'Oench* in tandem. *Id. See also Vernon*, 907 F.2d at 1105; *Olney Sav. & Loan Ass'n* v. *Trinity Banc Sav. Ass'n*, 885

II. THE HOLDINGS BY THE FIFTH AND TENTH CIRCUITS IN *OLNEY* AND *GRUBB* WERE NOT LIMITED TO THE FACTS IN THOSE CASES.

Respondent also attempts to harmonize the result reached by the majority in the court below with the decisions of the Tenth Circuit in *Grubb* v. *Federal Deposit Insurance Corporation*, 868 F.2d 1151 (10th Cir. 1989), and the Fifth Circuit in *Olney Savings & Loan Ass'n* v. *Trinity Banc Savings Ass'n*, 885 F.2d 266 (5th Cir. 1989). The respondent contends that the holdings in both *Grubb* and *Olney* were limited to their specific facts, and that since the facts of the instant case are distinguishable, there is actually no conflict. While petitioners concede that the facts in the case at bar are different from those present in *Grubb* and *Olney*, it is *not* true that those decisions were limited to their specific facts. Both the Tenth Circuit in *Grubb* and the Fifth Circuit in *Olney* clearly articulated the broad principle that the *D'Oench* doctrine has

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F.2d 266, 274 (5th Cir. 1989); *Beighley* v. *FDIC*, 868 F.2d 776, 784 (5th Cir. 1989).[2]

Twin Construction, Inc. v. *Boca Raton, Inc.*, 925 F.2d at 382. The above-quoted language is from the text of the opinion, but as can be seen there is also a footnote dealing with the same subject matter. The footnote is even more enlightening than the text regarding the Eleventh Circuit's views on the dichotomy between § 1823(e) and the *D'Oench* doctrine. The footnote states:

> We thus need not determine whether, because FDIC was substituted for FSLIC prior to the entry of summary judgment, the statutory codification in section 1823(e) rather than the common law of *D'Oench* and its progeny should apply to this case. *We will reach the same result regardless.*

Id., n.2 (emphasis added.) *See also Federal Savings & Loan Insurance Corporation* v. *Gemini Management*, 921 F.2d 241 (9th Cir. 1990); *Federal Savings & Loan Insurance Corporation* v. *Two Rivers Associates, Inc.*, 880 F.2d 1267 (11th Cir. 1989). It would seem, therefore, that the Ninth and Eleventh Circuits are also in conflict with the Sixth Circuit's holding in the instant case "that *D'Oench* and § 1823(e) are not identical in scope." Pet. App. 9a.

no application to situations in which no assets are acquired from failed insured institutions. The courts in *Grubb* and *Olney* outlined the facts simply in order to explain why no assets were acquired.

In *Grubb*, Grubb sued First National Bank & Trust Company of Oklahoma City ("First National") for securities fraud under state and federal laws. First National counterclaimed against Grubb alleging that it was due payment on certain promissory notes from Grubb. A jury returned a verdict awarding Grubb damages against First National in the amount of $2,722,629.88 and dismissing First National's counterclaims for payment on the notes. First National appealed. During the pendency of the appeal, First National was closed and the FDIC substituted as appellant. The FDIC then argued that it was protected by the *D'Oench* doctrine. The Tenth Circuit held, however, that "[t]he FDIC cannot claim the protection of *D'Oench* when a judgment already had voided the asset." 868 F.2d at 1159.

Likewise, in the *Olney Savings & Loan* case, Olney sued Trinity and obtained rescission of a participation agreement. Trinity then appealed, and, as in *Grubb*, the FSLIC stepped in as conservator for Trinity while the case was on appeal. The FSLIC then argued that the *D'Oench* doctrine served as a complete defense to Olney's claim that the participation agreement should be rescinded. The Fifth Circuit held, however:

> Even though the misrepresentations fall within the *D'Oench* definition of "secret agreement," FSLIC acquired no asset when it stepped in as conservator. Because the Participation Agreement had been voided by the entry of judgment for rescission, FSLIC *acquired no right, title or interest that could be diminished or defeated by the misrepresentations.*

885 F.2d at 274-75 (emphasis added).

Contrary to the arguments advanced by the respondent (Brief Opp. 7 & 8), the deciding factor in both *Grubb* and *Olney* was whether the FDIC and the FSLIC respectively acquired an asset from the failed institutions, not how or why assets were voided or diminished prior to those insured institutions being closed. It is obvious that the respondent misapprehends the import of the Tenth Circuit's decision in *Grubb* and the Fifth Circuit's decision in *Olney*.[2]

Interestingly, the respondent itself presented a substantial basis upon which the petition in this case should be granted when it questioned the correctness of the legal conclusions reached in *Grubb* and *Olney*. After questioning those decisions, the respondent speculated on what circumstances would justify withholding from the FSLIC or the FDIC the protection afforded under the *D'Oench* doctrine. The respondent's argument is as follows:

> First, *even if correct*, the decisions in *Grubb* and *Olney* would only preclude FSLIC or FDIC from invoking *D'Oench* to obtain appellate reversal of a district court judgment valid when entered.

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[2] In attempting to distinguish the case at bar with *Grubb* and *Olney*, the respondent misstates the facts in the instant case. The respondent states: "In this case, however, *petitioners instituted suit against FSLIC after Commerce had failed.*" Brief Opp. 8 (emphasis added). The record clearly reflects that petitioners originally filed this suit against Commerce in state court in April of 1987, and that the case was removed to United States District Court in August of 1988 by the FSLIC after the Federal Home Loan Bank Board declared Commerce insolvent and appointed the FSLIC receiver. In any event, respondent is incorrect in stating that "petitioners instituted suit against FSLIC after Commerce had failed." Just as in *Grubb* and *Olney*, the FSLIC became a party in this case as a result of the failure of an insured institution after litigation against that institution had commenced. Also, just as in *Grubb* and *Olney*, prior to Commerce being closed, the assets that would have been acquired by the FSLIC, the note and deed of trust, were voided by being paid in full.

Brief Opp. 8 (emphasis added). The above-quoted passage from the Brief in Opposition reveals that the respondent is less than confident in arguing *Grubb* and *Olney* are limited to their facts. By half-heartedly questioning the correctness of those cases, the respondent is saying, in effect: there is no conflict between the holdings in *Grubb* and *Olney* and the holding by the majority in the instant case, but if there is a conflict, *Grubb* and *Olney* are wrong. The respondent's analysis regarding the fact specific nature of the Fifth and Tenth Circuit holdings in *Olney* and *Grubb* is superficial. Those decisions were not so limited. While petitioners believe *Grubb* and *Olney* were correctly decided, petitioners' opinion in that regard, and the respondent's contrary view, can only be resolved if the petition for a writ of certiorari is granted and this case decided on the merits.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted,

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